

**THE EFFECTS OF CREDIT RISKS ON LOANS PORTFOLIO AMONG SACCO'S IN
THARAKA NITHI COUNTY, KENYA**

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DECLARATION

This project proposal is my original work and has not been presented for a degree in any other University

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DEDICATION

I dedicate this research project to my husband and children for the support and prayer through the entire process.

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It is befitting that my utmost acknowledgement goes to the almighty God for giving me strength and patience while doing this work. I am also highly indebted to my supervisor, Dr. John Cheruget for his valuable guidance from the time of proposal writing through to the finalization of the project. Deep gratitude goes to all my lecturers at Management University of Africa for the guidance and encouragement in pursuing this course to completion even when I thought I could not manage it, and for helping me in the preparation through to the final report writing.

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ABBREVIATIONS

BOSA	Back Office service activities
CAMEL	Capital adequacy, assets quality, management, earning and liquidity
CRB	Credit regulatory bureau
FOSA	Front office services activities
FG	Focus group
FSD	Financial sector deepening
KIE	Kenya industrial estate
LPM	Loan performance management
MFI	Micro-finance institutions
NPL	None performing loans
SACCO	Savings and credit co-operative society
SASRA	Sacco's societies regulatory authority

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ABSTRACT

Savings and credit cooperative societies (SACCOs), operates in an environment of considerable risks and uncertainty. Credit portfolio is one of the main challenges faced by financial institutions as well as the savings and credit cooperative societies in many parts of world. Thus, the main objective of the study was to establish the effect of credit risk management on the loan portfolio among SACCOs in Tharaka Nithi County, Kenya. The study specific objectives included establishing the effects of credit risk identification procedures on loan portfolio, assessing the effects of risk analysis procedures on loan portfolio, determining the risk monitoring procedure on loan portfolio and finally examining the risk management mitigation measures on loan portfolio by SACCOs. The study applied the descriptive research design and the target population of the study was 35 registered SACCOs in Tharaka Nithi County. The study applied the a systematic sampling procedure to identify the SACCOs and the sample size was all the SACCOs in the county since they were small in number. The data collection instrument was a questionnaire and before administering the questionnaires, a pilot study was conducted in the neighboring Meru County with six SACCOs to establish the validity and reliability of the study instruments. Qualitative data was checked for completeness and later analyzed using Statistical Package for Social Science (SPSS) version 22. The study findings indicated that majority of savings and credit cooperative societies in the County applied various credit risk identification methods on loan collection management. The most popular method of promoting credit risk awareness amongst the SACCO staff was through regular trainings, appraisal and constant supervision on the credits management staff. However, use of credit manual was not regularly used although its application is supposed to go hand in hand with regular meetings and supervisions. Most SACCOs followed the three month credit default policy period as the benchmark for credit default. However, it also became apparent that the SACCOs used a combination of credit default policies as opposed to just sticking to one. In most SACCOs credit risk management practice had a positive impact since it ensured there was efficiency in carrying out obligations to meet the intended objectives. Credit risk managers in SACCOs used a combination of methods but the most favored one was the credit limit followed by credit approval and credit control policy respectively. SACCOs credit committees, boards of directors and credit managers respectively were responsible for credit policy formulation . The executive management also registered a sizeable impact on credit policy albeit somewhat diminished when compared to the first three avenues of credit policy formulation. The character of the borrower was the most prominent criteria used in screening of potential borrowers amongst SACCOs. The SACCOs also set some conditions mainly involving duration of membership and amount saved. Collateral was also used but it was not the core criteria given that most SACCOs are able to attach member's incomes (salaries) and hence use these income flows as security. On the other hand, SACCOs that do not deal with salaried members, such as those comprising business people and artisans, were keener on collateral. Majority of SACCOs avoided sale of property, debt collection agencies and legal action. However, the SACCOs also try to avoid debt and interest write offs and instead prefer loan renegotiation and restructuring. All in all, letters of credit and telephone calls appear to be the most preferred first line of defense in dealing with clients who fall behind their loan repayment schedule.

CHAPTER ONE

INTRODUCTION

1.0 Introduction

The chapter contains the background of the study, statement of the problem, main objectives and the specific objectives, research questions, significance of the study, the scope of the study and limitation of the study.

1.1 Background of the Study

Savings and Credit Cooperative Societies (SACCOs) are mostly private or members owned intermediaries where members are sole owners through shares holding and membership is mostly open and voluntary. Savings and credit cooperative societies are financial organization owned and operated on not for profit basis by its members according to cooperative principles. Savings and credit cooperative societies in majority of developing countries have established a deeper and extensive outreach to the financial marginalized communities than any other type of financial institution (Njoku, 2007). Savings and credit cooperative societies have continued to provide savings, credits, financial training at the grassroots level (World Bank, 2012).

However, regardless of savings and credit cooperative societies existence, most financial sector in low-income countries in Africa and other parts of world countries seemed to have failed to serve the poor in regards to soft loans as a means of social economic growth in early 1960s. With respect to the formal sector, banks and other financial institutions generally required significant collateral, and they seemed to prefer high income loans clients who were referred to as the bankable clients Graziosi

(2006). Generally the loans advanced were associated with lengthy bureaucratic application procedures and sometimes associated with very high interest rate.

Mikwamba (2004) traces first SACCO in Africa to have been introduced in Tanzania in 1930s and in Ghana in 1959. These savings and credit cooperative societies were formed to assist villagers improve their social economic conditions. However, the first entrants into modern savings and credit cooperative societies offering micro credit in Africa include Ghana, Kenya, Uganda, Nigeria and Tanzania. In many countries in Africa, savings and credit co-operative society (SACCO) are formed with the intention of offering alternative source of financing the rural and urban low income citizens to improve their livelihood. In most cases these savings and credit co-operative societies are mainly community membership based financial institutions and they are owned by their members in promotion of their members economic interests (Graziosi, 2006).

Savings and credit co-operative societies' level of performance highly depends on the high loans recovery portfolio. Thus, the policies of execution, debts collection and discipline level are very important in SACCOs (Njoku, 2007). Also debit collection need to be carried out with outmost care, constantly and with consistency of analyzing loan portfolio. The SACCO'S management and loans officers are directly responsible for the implementation collection action and enforcing both the policies and procedures. According to Ogilo (2011) the policy framework on credit administration and credit collection plan need to be based on stages of validation

prior to loans advancement as agreed on. However, the collection procedures and discipline should complement with the primary loan portfolio granting and management plane by the financial institution(Reilly & Brown, 2011).

According to Ogilo (2011) the SACCOs credit management need to deal with the selection of portfolios which maximizes expected returns and should be consistence with the individual acceptable levels of risk. Loan collection management should provide a framework that specifies and measures investment risk. It should also develop the relationship between risks expected and returns (Ogilo, 2011). The main assumption is that investment must be considered because the return from the investment interest has a relationship with the returns from assets portfolio which is important in credit management (Reilly & Brown, 2011).

Credit risk management is one of the most expensive ventures in any financial institutions in comparison to other risks in financial institutions (Chijoriga, 2007). Majority of financial institutions worldwide face varied difficulties, but credit risks is the most profound compared to others. The main difficulty associated with credit risks is laxity of credit standards for borrowers, counterparties, poor loan collection methods, lack of attention and not putting into considering the risk management policies (Basel, 2009).

According to Mudibo (2007) there are a variety of credit risks in the entire processes and activities of financial institutions lending activities, which include banking books of credit and credit trading books which are normally exhibited in the journal of

entries as well as the balance sheet. However, the main purpose of risk management in savings and credit co-operative societies is to adjust the risk rates through maintaining credit exposure through agreeable limits (Kimanthi, 2007). On other hand Sinkey (2002) observes that SACCO societies should manage credit risks inherent with entire loans collection risk both at individual and cooperate credit transactions.

According to Branch (2005), credit collection procedure has a profound influence financial stability of a SACCO. However, the main decision in credit management include decision by finance staff, loan management, asset management and production innovations. Branch (2005) further observes that credits advanced are supposed to increase savings and credit cooperative society wealth, sustain savings and credit cooperative societies value and shareholders demand satisfaction. Mudibo (2005) also observes that credit management aspect in savings and credit cooperative society is responsible with updating accounts, encouraging correctness of account, planning and reporting. Kimathi (2007) stated that prudent credit advancement strategy by the SACCO is an important practical faction which is supposed to make the SACCO stable. The practice involve making decisions of committing the savings and credit cooperative society credits benefit to a planned investment option,

There are different types of savings and credit cooperative societies in Tharaka Nithi County and they can be categorized into two; Urban SACCOs and Rural SACCOs. Urban savings and credit cooperative society are formed by members who are either employed or get consistent monthly income like Trans Nation Sacco which

membership is drowned from teachers in Tharaka Nithi County. Rural savings and credit cooperative society are formed by members who actually get inconsistent incomes through farm produce and small enterprises Kimathi (2007). The main economic activity commonly done by the members, form the common bond for the Sacco.

Majority of savings and credit cooperative society in Tharaka Nithi County operate front office services (FOSA) as well as back office services (BOSA) thereby accepting deposits from members. They operate savings accounts just like banks as well as loan accounts which attract interest respectively Kimathi (2007). In Tharaka Nithi County there are 35 vibrant savings and credit cooperative society with a client base of over two hundred thousand members. The SACCOs in Tharaka Nithi county offer a wide variety of services which include salary processing, loan processing, dividends and deposits processing, produce payment, checks clearance, bankers checks, interests on savings under front office services (FOSA), farmers account, counter withdrawal charges, notice fees charges on lump sum withdrawals (Kimathi, 2007).

1.2 Statement of the Problem

The main objective of savings and credit cooperative societies in Tharaka Nithi County is similar to other SACCOs in Kenya. The main objective of savings and credit cooperative society is to empower the citizen through savings mobilization, disbursement of credits and ensuring that the SACCOS' gets long term sustainability through careful monetary performance. Kimathi (2007) in a study of savings and

credit cooperative society in Tharaka Nithi County noted that regardless of vibrant micro credit facility offered by savings and credit cooperative society, many SACCOs are faced by poor credit portfolio investment decisions and mismanagement which makes many savings and credit cooperative society to perform poorly. However, according to Sacco Society Regulatory Authority report of 2011, loans disbursed by savings and credit cooperative society to members accounted to 30% of total loan assets.

SASRA (2011) also observed that the quality of loan portfolio was the biggest challenge because the average non-performing loans (NLP) accounted to 10% for all savings and credit cooperative society which is contrary to SASRA regulations which states that the level of none performing loans should not go beyond 5%. Observably the levels of non-performing loans are very high and underline the need for the savings and credit cooperative society to enforce credit policies to reduce loans non payment risks. However, the weak investment choice and capital foundations and debts mostly affect and exposes savings and credit cooperative society to credit risks. However, the current study main objective was to analyze some of loans risks management techniques in SACCOs loans portfolio. Some of the study done in regard to savings and credit cooperative society in Tharaka Nithi county were more on performance and employee motivation, but none had been done on credit risk management in the County.

1.3 Main Objective of the Study

The main aim for the study was to establish and analyze the effects of credits risks management processes on loans portfolio among savings and credit cooperative society in Tharaka Nithi County, Kenya.

1.3.1 The specific objectives of the study

The study was guided by the following specific objectives

- i. To establish the effects of credit risk identification techniques on loan portfolio among Sacco's in Tharaka Nithi County.
- ii. To assess the effects of credit risk analysis procedures on loan portfolio among Sacco's in Tharaka Nithi County.
- iii. To establish the effects of credit risk monitoring on loan portfolio among Sacco's in Tharaka Nithi County.
- iv. To establish the effects of credit risk mitigation measures on loan portfolio among Sacco's in Tharaka Nithi County.

1.4 Research Questions

The study was guided by the following research questions

- i. Does the credit risk identification method have any significant effects on loan portfolio among Sacco's in Tharaka Nithi County?
- ii. Does credit risk analysis have any significant effect loan portfolio among Sacco's in Tharaka Nithi County?
- iii. Does credit risk monitoring have any significant effects on loan portfolio among Sacco's in Tharaka Nithi County?

- iv. Does credit risk mitigation measures have any significant effects on loan portfolio among Sacco's in Tharaka Nithi County?

1.5 Significance of the Study

The study shall assist the savings and credit cooperative societies' management to appreciate credit risk management portfolio and its impact. Management will also have opportunity to review credit risk management practices and on the impact of financial performance. Additionally the study will be important to the academic community because it broadens the knowledge levels on credit risk management practices of financial management of savings and credit cooperative societies in Kenya. The study will provide a basis for upcoming researchers on the areas of credit risk management. The study shall also assist the credit officers, managers and directors of SACCOs management with guidelines to follow when choosing approaches' to manage and mitigate credit portfolios in savings and credit cooperative society sectors.

The study will also offer modern-days knowledge on credit risk management methods that will be applicable in identifying risks and controlling risks effectively in savings and credit cooperative societies to enhance loan portfolio performance. The SARSA and Credit Regulatory Bureau (CRB) which are arms of government dealing with credit regulations will get a referral document to visit when formulating policies regarding credit taxations management and other regulatory requirements on the savings and credit cooperative societies. The policy makers will come up with effectual policies to safeguard the interest of the SACCO loans borrowers and the

lender on maintaining good participation and relationships. The SACCOs shareholders and other interested parties will benefit from the study since it will create awareness in understanding the circumstances under which the loans operate and the interest of the SACCOs to reduce conflict between credit officers and loans beneficially. The study findings will provide basis for future and further research in the same area.

1.6 The Scope of the Study

The scope of the study shall include all the 35 licensed savings and credit cooperative societies' by SASRA and operating in Tharaka Nithi County. The area was considered appropriate due to high number of savings and credit cooperative societies and the high rate of loans need by farmers, business people and the employed. The scope was considered appropriate to satisfy the research objectives guiding the study.

Limitation of the Study

The main limitation was that the study was only applicable to the savings and credit cooperative societies in Tharaka Nithi County, and the finding might not be a replica of what happens in other counties in Kenya. However, by extension the findings could not be applicable to other financial institutions because the loans portfolio management is different. The other limitation was that the relevance of the information obtained was limited to the time within which the study was carried out. The other issue was that SACCOs have different lending policies which keep on changing and thus, the study findings may be irrelevant to a different area of the country.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

The chapter reviewed literature related to savings and credit cooperative societies' credit risk portfolio management and the literature was from other scholars. The chapter specifically provided the theoretical literature review, empirical literature review, summary of the review and research gaps, the conceptual framework and lastly the summary of the chapter.

2.1 Theoretical Literature Review

SACCOs Performance mostly depend on the quality of if the portfolio according to Alexandra (2006). Alexandra further stated that the SACCO performance is mainly determined by governance structures in place and the management. Chipendere (2009) also stated that despite financial deficiencies experienced by many SACCOs, they still have loan product tailored to shoot the low-risk borrower members regardless of vague risk management in some SACCOs. According to SASRA (2011) Sacco managers need to manage loan portfolio to reduce risks of default because the cost of loan recovery is high as well as the time take in recovery process a statement also identified by (Eales and Bosworth, 2008).

According to FSD (2009), Savings and credit cooperative societies normally operate under objective of maximizing benefit to shareholders to achieve their goals and standard of living. Mwisho (2011) observes that credit risk management role can as well conflict with financial observed that the roles can conflict with the financial practices when the credit management does not put in place tough measure of giving

out credits and also not monitoring credit risks of the borrowers at individual levels.. Ogilo (2011) observes that the non-performing loans normally leads to stagnation of SACCOs financial resources and sources. Ogilo, further stated that the effectiveness of credit risk management largely depend on the managers assessment of loan defaulting levels in the SACCO . Notably is that the loan portfolio by SACCOs typically are based the income levels, occupation, employment status and credit history of the borrowers before lending the money (Higgins, 2009).

According to Ogilo (2011) savings and credit cooperative society societies level of sustainability mostly is dependent of high recovery level of loans portfolio (Michael & Sproul, 2008). The policy of loan collection and disciplines are very important and need to be carried out consistently on loan portfolio. The procedures and policy regulations for credit collections activities should be based on laid legal procedures of loans advancement by the savings and credit cooperative society societies (Kimanthi, 2007). As a result it is stressed that collection policies and procedure need to measure complementary primary loan portfolio management activities (Kablan, 2010).

The savings and credit cooperative society managers mostly rely on the effectiveness of credit collection set rules and regulations to avert future credit portfolio challenges (Kimathi, 2007). Kimathi further observed that there are different ways such as market position of which savings and credit cooperative society societies can identify credit risks. Also market failures and natural phenomenal can be a good indicator of either advancing a loan or not and the market failures can also depend on the internal

process and the action taken by the management. Njoku (2007) stated that savings and credit cooperative societies credit risk management need to be active and vigorous in the process of loan recovery process to enable the savings and credit cooperative societies manage loan collection to minimize the losses. The importance of the savings and credit cooperative societies loan portfolio management is also applicable of other financial institutions like bank because it is the benchmark of standard of debt collection processes all over the world (Focus Group, 2007)

According to Malimba & Ganesan (2009) majority of banking institutions apply credit risk management portfolio because of the uncertainty associated with borrowers defaults which is not healthy for them. The loans repayment uncertainties remain a major challenge to many banks in different countries of the world. (Malimba & Ganesan 2009). The main approach applied by majority of banks in Kenya included continuous monitoring of loan advanced and unpaid. However, credit monitoring systems are the key source of uncertainties which include data collection and generating in the institutions (Uchendu, 2009). In banking sector the market structure dictates and influences the competition in the banking systems.

On the other hand the SACCOs target borrowers from shareholders, members and other people who mostly lack collaterals. In savings and credit cooperative societies priority of advancing loans is pegged on priority in disregard of income earned, but they apply strict loans advancing criteria to low income borrowers leading to the exclusion

of these needy class of borrowers in financial systems (Cheron et al, 2009). Malimba & Ganesan (2009) observes that in many times savings and credit cooperative society fail to accommodate credit risks increases such as loan default or totally defaulting.

2.2.1 Credit Risk Theory

The study applied the credit risk theory by Markowitz (2002). Through credit risk theory Markowitz, pointed out that credit risk is a challenge which as faced my loanees for centuries although it not area that has been researched widely till 1930s. Available literature on loans management portfolio applied the old traditions method of actuarial in establishing credit risk which is deferent to today credits dynamics. Markowitz (2002) also observed that in traditional methods the lender somehow completely depended on history of the borrowers rather that actual and current data. Higgins (2009) observation of Markowitz credit risk theory insists of three quantitative approaches to when analyzing credit risks, as the credit offered structures and approach, appraisal method and information dissemination method which incorporates awareness by both entities in the deal. Melton introduced the credit risk theory also referred to as the structural theory which is delivered from a firm's assets evaluation by distribution process with continuous limitations. The models were mainly defined as "structural model" and it is based on variable reflection of specific issues. The evaluation of this structural groups are represented by the assets representation where the loss conditions of defaulting are specific. However, according to (Haggins, 2009) the model of credit default is a continuers process throughout the life of financial institutions cooperate bond.

2.2.3 Agency Theory

Another theory applied in this study was the Agency Theory by Tipuric (2008). Agency theory was a framework used to analyzing conflicting interests between key stakeholders. It was also additionally developed as a mechanisms for resolving conflicts (Tipuric, 2008). The agency theory application is extensively prevalent to the contribution in the discipline of corporate governance. According to Basel (2009) agency theory is applicable in situations where one party (the principal) commands or delegates work to others who are termed as (the agents) to perform certain work.. Agency theory frequently explain the connection in terms of behavioral distinctiveness and provides mathematic tool for evaluating situations between parties who lack shared trust. Agency theory is very relevant to credit collection management by the mangers (Tipuric, 2008). The encouragement or motivation factor for agency theory development is on the relationship between ownership and control purpose within financial institutions.

According to Pioneer et al (2006) many financial cooperation's do not operate according to maximization principle mainly because of conflict of interest of the governing entities. Jensen & Meckling (2006) also attribute agency theory as exchange relation between principals and agents and the for the cases of this study it apprise to theory describes economic exchange relation between principal and agent and the case of this study it applies to savings and credit cooperative society (SACCOs) and other credits advancing entities. However, the principal agent relations, in which principal delegate their work to agents is just a mare metaphor of

contracting the agents (Jensen & Meckling, 2006). Thus, the objective of the study was to determine whether there is optimal contract between principals and agents.

According to Haggins (2009) opines that the agency theory explains the relationship between the principals as the member and agents in the running of savings and credit cooperative society. As per the agency theory (Jensen & Meckling, 2009) states that the members who are the owners or principals of the savings and credit cooperative society, elect the management board as their agent. The principals who are the (members) delegate the daily running of business to the management board which in turn hire and delegates authority to the managers' (Clarke, 2004).

2.2.4 Loan Portfolio

Loan portfolio are the loans on default or held by the borrowers without payment (Haron and Hin Hock, 2007). Loan portfolio in many savings and credit cooperative societies are the major assets and source of interest. The worth of loans collected in most cases are not pegged on the interest rate they earn, but the probable principle interest they hold (Jensen & Meckling, 2009). In many financial institutions advancing of loans and mostly inform of cash is the main business of banks and SACCOs and the loans collection is the main source of income.

In other words, loans in a financial institution are the greatest source of risk because of the safety of cash awarded and the soundness of the advanced loans to clients. However, this depends with the keenness, tolerance by credit officers, information sharing, willingness of the borrower to repay, economic standard of the time, terms and conditions among others. In many financial institutions credit repayment

challenges has been there time in memorial characterized with financial losses and defaults putting these institutions in danger (Kuusela & Ollikainen, 1998). However, the effectiveness of the loan portfolio management on the credit factions is fundamental to savings and credit cooperative societies' soundness and safety. The Loan Portfolio Management (LPM) is one of the best process applied by financial institutions to manage and control credit risks (Focus Group, 2007). LPM is very important and it's a primary supervisory activity of the management in every financial institution (Koch, 2000).

Kuusela & Ollikainen (2008) observed that poor loan collection and management starts when the loan managers fail to notice and evaluate individual borrower. A continues risk monitoring criteria is paramount in planning and maintaining individual loans quality in financial institution. Thus, chronological importance of calculating worthiness of personal loan approval is as important as monitoring loan performance of the same individual granted the loan. However, with the new technology and changing information systems, doors are opened to better portfolio management method in the savings and credit cooperative society societies (Kimanthi, 2007). With new technology the portfolio manager has options of obtaining early indicators of increasing or reducing the risk by having a more all-inclusive view of the loan management (Koch, 2000).

According to Mudibo (2007) the savings and credit cooperative societies' managers need to manage their portfolio by understanding the risk posed by each credit and by understanding how individual credit risk are interrelated. The credit manager must

understand this stage because it is an interrelationship and can multiply risks many times beyond what one expected because the risks were not related.

Sinkey, (1992) observes that it was just recently that when many banks had started approving and adopting the new credit management concept when controlling credit default. Also as noted by (Kimanthi, 2007), it was very recent in late 1990s when SACCOs embraced the loan portfolio as a division in the general running of SACCOs in many parts of Kenya. This acquired practice has provided many financial institutions management such as banks and savings and credit cooperative societies' with complete picture of how to manage credit risk profiling and other tools of analyzing and controlling credit risk (Sinkey, 1992).

2.2 Empirical Literature Review

According to Malimba & Ganesan (2009) with effective credit portfolio management, not only helps in detecting poorly underwritten credit. In many ways it helps prevent weak credit from being granted. Credit management also helps the credit officers to be more industrious by knowing their work and being the subject of continuous review on the credit portfolio. The major challenge faced by majority of banks and financial institutions in late 1980s and early 1990s was that there was failure by financial institutions to monitor borrowers on basis of collateral values of assets before advancing loans. Majority of banks during that period neglected acquiring proper financial information of the credit borrowers in relation of real estate facts and monitoring and evaluating quality of collaterals (Malimba & Ganesan, 2009). In their result, many banks and financial institutions failed to identify early on signs quality of assets to protect the institutions financials which in effects affected the institutions

assets and those of the stakeholders. Lack of monitoring in the financial institutions by then lead to costly processes by senior management in determining the dimensions and severity of the problematic loans which resulted to large losses.

2.2.1 Risk Identification

Jansson and Norrman (2004) define risk management process of focusing and understanding the risks, and means of minimizing their impact. Kuusela and Ollikainen (2008) describe the risk management process as risk identification, measurement and analyzing, controlling and finance, evaluation and cost calculations. Credit risk identification is very important when dealing with risk management in financial institutions and more specifically in the savings and credit cooperative societies'. However, to manage risk in SACCOs effectively the management should identify the risk associated with every transaction before any loan advancement. The first step on risk identification by SACCOs is by identifying the key risks which can as well be revisited, reviewed and approved by the board of management with guidance of the credit management committee. The SACCO also should also evaluate the degree of loans advancement risks, the level of tolerance and time of repayment among the positive and negative impact of credits if not controlled. The SACCO also need to analyze the risk faced in the areas of credit management, liquidity, strategic risks, interest rates risk and operations risks (Sinkey, 1992).

Commercial banks risks practice management according Markowitz (2002), is that commercial banks mostly face credit portfolio risks due to management failures. But Al-Tamimi (2002) in his observations stated that inspections by the branch managers and the the financial statement analysis was the main procedure used in risk

identification by financial institutions. Majority of commercial banks and savings and credit cooperative societies' main technique for credit risk management is by putting in place standards on credit scores, credit worthiness analysis, risks rating procedures and availability of collaterals. In a more recent study by Al-Mazrooei (2007) also established that in majority of banks the most common type of risk encountered includes foreign exchange risk, followed closely by credit risk and then operation risk. Al-Mazrooei (2007) advises that risk identification significantly influence risk management practice more positively.

A study done Haron & Hin Hock (2007) specifically on banks risks identification and risk mitigation identified inherent credit risk and credit market risk exposure. Haron & Hin Hock, (2007) also illustrated the concept of displaced commercial risk that were important to the banks by concluding that certain risk can be considered as being inherent in their operations in the convectional banking institutions. Although in comparison, the risk exposure of banks differs with savings and credit cooperative societies' the principals of credit risk management applies to both entities. Focus Group (2007) additionally observed that the standards of risk management and capital sufficiency are guiding principles that marks the first steps of providing good standards by filling the regulatory gap that exist in portfolio management. In a study by Griffins (2009) on twenty eight Islamic banks which looked at the perception of management on risk management methods, the study established and concluded that individual evaluation was the most important factor to consider as well as gathering relevant information about the applicant and analyzing the information to determine the credit worthiness before making any decision (Griffins, 2009).

2.2.2 Risk Analysis and assessments

According to Fatemi (2000) the typical process of analyzing risk normally has two mechanisms. The first one is the financial analysis which includes analyzing financial quantitatively and qualitatively. This is characterized by analyzing the available financial applicant data and analyzing annual financial statement of applicant who is the central and key determinant of default or repayment in this context. In such cases the financial breakdown of the applicant is done by credit analysts and by following the general guideline guiding the analysis to conform to organizational components of credit analysis before credit considerations. Then the files are forwarded over to credit manager for consideration or advice (Eldelshain 2005)

There are numerous concrete studies done on the risk analysis and assessment in reference to measurement and mitigation of credit risk in financial institution. In practice they all practice classify the different risk associated with credits advancement and the most likely damages the possibly pose to the financial institutions where Savings and credit cooperative societies are included (Fuser et al, 2009).

Fuser et al (2009) also points out that classification of credit defaults enables the management to identify risk and evade the risk that may threaten the survival of the corporation from which they may cause damage. Fatemi (2000) on other hand observed that, there is an inverse relationship between the expected amount of loss and its corresponding likelihood, and this include risk that can cause a high damage to the institution, others included natural calamities such as earthquakes, landslide or

fire. However, risk occurs daily such as interest rate risk or foreign exchange risk which causes some relatively minor losses although these risks can sometimes influenced interest rates of a financial institution (Strutt, 2003).

In current status of many financial institutions such as banks and savings and credit cooperative societies' risk analysis goes beyond evaluation to include other things like decision making process in risk management(Griffins, 2009). Another important aspect of credit management is brainstorming, which is the main sensitive practice involving a group generating ideas. In this groups the people generate ideas from their heads with a philosophy of nobody knows better or nobody is wrong which gets the idea on board (Strutt, 2003). Brainstorming is quick and simple to apply but it lacks the comprehensive approaches in comparison to the more sophisticated techniques (Strutt, 2003).

Alexandra (2006) give a very comprehensive risk measurement and mitigation method. Alexandra, identified some risk which can arise from financing activities in a financial institutions which included categorizing in form of nature of profit and loss sharing, source of funds especially in investments account holders among others. Sundrararajan (2007) in his study concluded that the application of modern approaches to risk measurement and particularly on credit is very vital to the overall bank and other financial institutions credit portfolio management. Kimanthi (2007) on other hand advices' the financial institutions to adopt the new measurements approaches and more in particular in the SACCOs because of the role they play and the uniqueness mix of the risks in the because of the role they play and the uniqueness mix of risk in the SACCOs contracts.

In a study by Olomolo (2002) established that loans repayment performance was mostly affected by borrowers characteristics, lenders characteristics lenders and the model of the loans applied. Kimanthi (2007) also found out that loan repayment performance in some SACCOs in Meru South was mostly influenced by the borrowers characteristic, lenders characteristics and more that the type of loans advanced. Also identified by Kimanthi, was repayment challenges in form of loans delinquency and default. According to Kilonzo (2011) in whatever case, the borrowers cannot be held responsible for every case of default, but there is need to examine whether the borrower and the lender have fulfilled all the loans requirement as per the contract. Further it is important to establish the responsibilities and obligations of all parties as indicated in the credit program rather than blaming the borrowers all along.

2.2.3 Risk Monitoring and Mitigation

Ahlén (2012) established that credit manager's procedure of approval of loans applicants and revisiting old credit portfolio was the most important ingredient in management of credit risks in the savings and credit cooperative society. Ahlén (2012) further stresses that credit offering institutions need to put in place guidelines which should be written for credit approval process as well as the approval authority. Kilonzo (2011) observed that the board of directors and the management in a savings and credit cooperative society need to always monitor loans, and be the approval authority for new big loans and credits, to also renew the existing credit changes in terms of existing conditions from the previous credits. Particular attention need to be observed in reforming the guidelines and they should also be documented fully and appropriately recorded. However, precautionary loaning procedures in the savings and

credit cooperative society requires that every officer responsible for credit approval and related businesses should be well equipped with customer relationship knowledge so as to maintain credit client base for the institution. The approval authority should also have customer relations responsibility as approval authority and should be commensurate to the position within the management ranks as well as the expertise required (Mwisho, 2001).

Alexandra (2006) attributes the main functions of risk management to include monitor, measure and control credit risk in an institution. Alexandra (2006) further observed that the effective risk management requires reporting and reviewing structures to ensure that risks are effectively identified. Risks also need to be assessed and appropriate responses control process put in place. Alexandra (2006) further observes that risk monitoring and evaluation process make sure that risks management practice are in line with procedure put in place. Also a proper risk monitoring method need to be put in place to help the savings and credit cooperative societies or any other financial institution to discover mistakes at early stages (Alexandra, 2006).

In a study by Khan and Ahmad (2001), found out that on average risk management practice officers did not measure, mitigate or monitor risk at 69%. However, 82% implemented the policy and procedures, while internal control of bank was low at 50%. Al- Tamimi (2007) established that there was no significant deference between United Arab Emirates (UAE) nationals and foreign banks in controlling and monitoring credit risks. However, areas of interest rates risks were the second area of

main interest in the continuers monitoring and management practices of majority of banks. On the same study it was established that majority of commercial banks made patent difference between other financial institutions source of income and balance sheet interest exposure. As such monitoring was the last step in the risk management process among all studied banks (Akperan 2005).

2.2.4 Credit Risk Management Measurement

Many firms consider operation and financial ratios as a tool for determining credit portfolio conditions and performances (Mudibo, 2007). Sinkey (2005) gained popularity when he utilized discriminates warning model to identify and distinguish problems in the banks and the model worked and has been applied by many financial institutions globally. Sinkey (2005) on other hand examined savings and loan industry. He used the rating system known as (CAMEL) capital, adequacy, assets quality, management quality, earning and liquidity to identify the financial distress in varying banks. The outcome of the study was financial soundness of majority of banks.

CAMEL rating is applied by many banks as well as the central bank of Kenya for assessing the soundness of financial institutions (CBK, 2010). However, majority of investment banks generally view the interest rates and credit risk as classic part of daily market risk. Through CAMEL systems majority of investment banks have been able to develop detailed business trading risk management system to determine and supervise exposure to credit risks (Kilonzo, 2011). However, this cannot be fully suitable for financial establishment that have modest trading activities, but work

primarily on behalf of consumers, but the deficiency of sufficient trading systems in the industry in some becomes stressful (Strutt, 2003). While there are some shortcomings on underwritings management on market related credit, exposure of the same presents good source of losses at the bank (Strutt, 2003). Kimathi (2007) also notes that many credit problems can be avoided or mitigated if there is a strong internal credit audits processes. However, in most of traditional banks lending, competitive pressure and the growth of loan syndication techniques creates time constraints that interfere with basic due diligence.

2.3 Summary and Research Gaps

Al- Tamimi (2007) studied the risk management systems Islamic banks in United Arab Emirates (UAE), where he examined the perception of managers on credit risk management procedures. Al- Tamimi study revealed that majority of Islamic banks was also exposed to the same types of credit risks just like convectional banks although it depended with the risk levels. Al- Tamimi (2007) also established that the loan repayment pace was considerably affected by the characteristics of both the lender and the borrower compounded by the loan characteristics. The identified repayment challenges included loans delinquency and defaults. However, the borrowers alone were not established to be the responsible for every problem which arouse because everyone involved in the line had a role to play in the whole circuit. Al- Tamimi finding was also supported by (Olomola, 2002) who advises that it is important for the people concerned need and should examine the level at which the both parties borrower and lender comply with loans contract as well as personality, responsibility and tasks of parties concerned.

Basel (2009) studied the role of credit risk management committees and the following was observed there was basic weakness on credit granting and monitoring process. The other shortcoming established included the underwritings and management of market related credit risks exposure, which in turn represented important source of losses in the banks. However, many credit problems in the banks can be avoided or mitigated by strong internal audit procedures, but many credit officers and managers ignores the entire process to the detrimental of portfolio management. Basel (2009) also noted that many banks had a challenge in carrying out a thoroughly and substantial credit assessment with the basic due diligence.

Eales and Bosworth (2008) also established that the lack of validations and testing of fresh loaning procedure was challenging many banking institutions. Many banks used untested new lending methods and innovations in the areas of credit market on dispensing loans without sound principles of benchmarks for leverage of granting the loans. Eales and Bosworth (2008) further observed sound practices called for application of basic principles on new type of credit creativity. Eales and Bosworth , also noted that some credits troubles happen due to skewed decision making procedure by senior credit manageress in the banks, where (Kimanthi, 2007) also observed was the same case in SACCOs where senior managers influenced credit awarding without following procedures. The skewed decisions included giving credits to organizations and companies they own or which they are members, credits to next of keen and personal friends, credits to politicians or to people with reputation for financial expertise and sometimes to meet personal agenda like creating personal

special relationships with rich and mighty in the community for personal gains (Kimanthi, 2007).

Kilonzo (2011) observed that credit review does not only assist the savings and credit cooperative society management to detect poorly underwritten credit but also assist in preventing weak credit from being granted. Also noted was that credit officers in the savings and credit cooperative society were more likely to be attentive with their work when they knew their work was being evaluated and monitored. Kilonzo (2011) also noted that the most common and very important problem which faced many SACCOs in mid 2000 was the failure to monitor borrowers in form of collateral value.

Kilonzo (2011) findings also concurred with previous study by (Kimathi, 2007) which also established that many SACCOs ignored the role of obtaining constant financial information of borrowers and real estate appraisal in evaluating the quality of loans in their books, the collaterals at hand when approving loans. The result was many SACCOs failed to see early signs that things were not good because the quality of assets was not commensurate with the value of good or collaterals owned by borrowers and to look for ways of curtailing their financial deterioration and protection of SACCOs position. As observed was laxity by SACCOs lead to costly process by senior management in determining the dimensions to be followed (Kimathi, 2007).

Njoku (2007) opined that the failure by many SACCOs to perform adequately was due to poor diligence in financial analysis and monitoring the borrowers to detect

credit-related challenges they face. In many SACCO related fraud losses were a result of neglected inspection routine of collaterals like goods provided, showroom floor for establishing the authentic and value of financial assets presented as collaterals and also auditing the financial statements and carefully analyzing them. Njoku (2007) stated that effective review as a SACCO department and independent collateral appraisal is vital as a protecting measure to make sure credits officers and other insiders does not conspire with borrowers.

In another study by Ogilo (2011) many savings and credit cooperative society have experienced credit losses due to failure of applying sufficient caution with leveraged credit arrangement. The credit extended to well influential borrowers were possibly to have huge losses in non-payment and likewise, major formation like the take over and debit improvement and planned strategies with written decision in general intensified credit risks into the bank loans collection. Ogilo (2011) also observed that many SACCOs in Kenya, credit lending actions involved giving loans with genuine collaterals. However, in lending against real assets, savings and credit cooperative societies unsuccessfully made insufficient valuation of correspondence between the financial environment of the borrowers and the price changes. Thus, the liquidity of the market value for the collateral assets declines. Thus, when the borrowers income and the principle source of loan serving in attached to the to the property which is in question, then it leads to deterioration of the borrowers income stream due to changes in the industry compounded by regional economic problems. This mostly accompanied by decline in assets value of the collaterals in question.

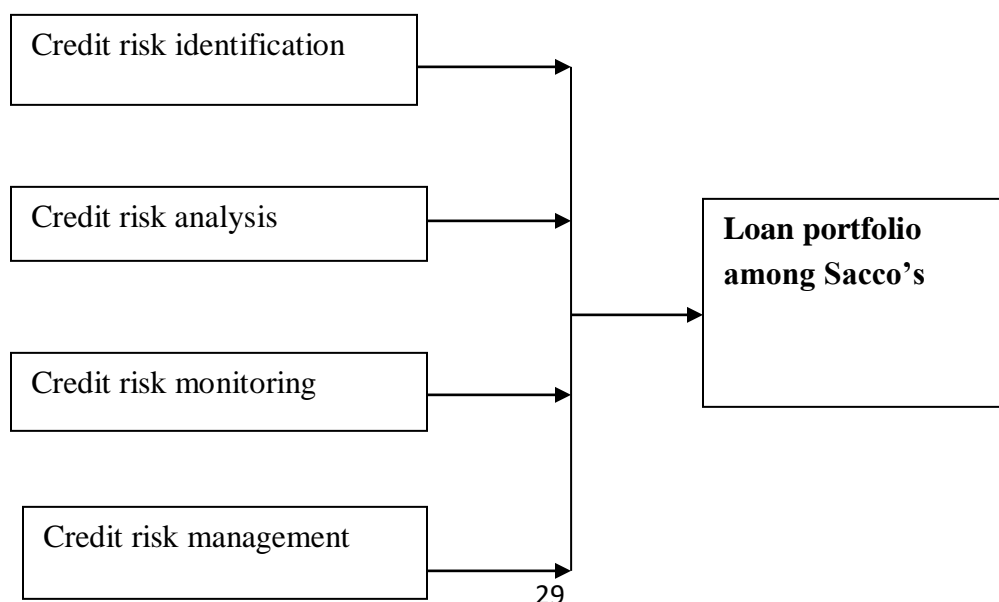
In another related study by Mwisho (2011), he concluded that assets based consumer lending on either homes as equity and automotive financing, hand a similar relationship because the financial health of the borrower were weak and thus affecting the credit portfolio of the SACCO. In the same case, the SACCO related problems included insufficient information of the account business cycle which affects the lending. Prospects and assets values in such cases rise on an ascending order in products cycle, where the credit analysis many incorporate astronomical assumptions (Mwisho, 2011).

2.4 Conceptual Framework

The conceptual diagram below shows the interdependence of the study variable. The conceptual framework shows the systematically organized variable interrelations. In the framework the savings and credit cooperative societies' loan portfolio depends on the credit risk management for the savings and credit cooperative societies sustainability and performance. The independent variables included risk identification, analysis, monitoring and management.

Independent Variables

Dependent Variable



2.5 Explanation of Study Valuables

2.5.1 Risk Identification

The risk identification techniques and instruments are the tools which savings and credit cooperative societies have in place to identify the current and existing potential of loan default on the leading activities in the savings and credit cooperative society. This included the improvement, development and implementation of clearly defined policies guiding loans portfolio management and lending policies to effectually manage and control credit risks.

2.5.2 Risk Analysis

These are the techniques which the SACCO applies to calculate the credit worthy of loaned. It involves examining the sources of capital to repay the loan as well as the credit history of the borrowers in a stipulated length of time. The risk analysis technique looks more keenly on the ability, policy requirements and credit manager judgment of the loan seekers. Credit management policy are also used to check on the risks involved to ascertain whether it is a good or a bad loan.

2.5.3 Risk Monitoring

Loan monitoring is the constant as well as timely process of monitoring effectually the credit functions. It is also the art of the management to control the credit factions and the membership loans. The risk monitoring faction is a continuous process in a SACCO and it follows laid down guidelines to effectively monitor and control credit portfolio. The process encompasses identifying the account problems, revisiting the account frequently, making planned follow ups and taking corrective actions as per the SACCO credit policy.

2.5.4 Risk Management

Risk management provides protection to an exposure which the savings and credit cooperative society continue to hold. Savings and credit cooperative societies have to put in place internal measures to manage credit portfolio by having regulatory capital lending subject to meeting laid down conditions and approval regulations procedures. This can include internal credit risk management systems.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.0 Introduction

The section outlines research design and method applied. The chapter described the study design applied and the target population. In addition, the chapter gives the sampling design, the instruments used and the reliability and validity of instruments, data collection procedure and data analysis method used are all described.

3.1 Research Design

The study applied the descriptive research design. The study adopted the descriptive research design since it was to answer questions concerning the current trends, conditions and status of the subjects under the study. Descriptive research design describes the characteristics of the subjects under study (Cooper and Schindler, 2003). Through the use of descriptive design, the researcher was able to have the whole picture of credit portfolio in SACCOs. According to Cooper and Schindler (2003) a descriptive design describes the existing conditions and attitudes through observation and interpretation techniques. Through the descriptive the study was therefore able to generalize the findings to all Sacco's licensed by SASRA in Tharaka Nithi County.

3.2 Target Population

The target population for the study was 35 SACCOs operating in Tharaka Nithi County, which are licenced by SASRA at as per 2017. According to SASRA there are 35 deposit taking SACCO operating in the county and they formed our target population.

3.3 Sample and Sampling Technique

According to Cooper and Schindler (2003), when the target population is small less than 100, a sample size of over 50% is adequate for descriptive study. As per the population of the study, there were only 35 active SACCOs and thus, the researcher opted to cover them all as a samples size which is over 50% and it was in line with (Cooper and Schindler, 2003). Thus, the study sample size was 35 savings and credit cooperative societies.

3.4 Research Instruments

The study used a questionnaire as the study instrument. The questionnaire was used to collect the primary data. The primary data was collected using structured and unstructured questions on the subject matter or study objectives. The study secondary data was collected from journals, booklets, scholarly materials as well as SACCOs and SASRA publications and financial statements.. The questionnaires was administered by multiple approaches method which included (drop and pick method) on the counter of respectful SACCOs. Emails and short messages (SMS) was used by the researcher as a means of follow up and remainder.

3.5 Pilot Study

The research instrument was pilot tested in order to determine both reliability and validity prior to administering it in the main study. Validity was determined through expert opinion of five randomly chosen Sacco's in the county while the reliability was tested using the alpha coefficient. Only those factors in every construct that returned alpha values equal to or greater than 0.7 ($\alpha \geq 0.7$) was be deemed reliable and as such include in the final instrument.

3.5.1 Validity

To test the instrument's validity, a pilot study was carried out. The content in the research items were based on the study objectives. Unclear questions, or amendments that could have been forgotten or left out in structuring of the questions were detected and the tool revised in preparation for the main study thus improve the construct validity.

3.5.2 Reliability Test

Reliability was ensured by subjecting the instruments to the test retest technique whereby they were administered twice within a period of two weeks. The results from the two tests was then correlated using Spearman's correlation coefficient (ρ). A coefficient of 0.7 as Mugenda & Mugenda (2003) explains will be deemed reliable. The instruments reliability was obtained after a pilot study of 5 SACCOs which were not to be in the final study.

3.6 Data Collection Procedure

The researchers first sought for permission to collect data from MUA and the SACCOs. After getting the permission the researchers administered the questionnaires through multiple approaches method which included (drop and pick method) on the counter of respectful SACCOs. Emails and short messages (SMS) was used by the researcher as a means of follow up and remainder. The study secondary data was collected from SARSA and SACCOs journal and publications, as well as scholarly materials, books and internet.

3.7 Data Analysis and Presentation

Data analysis is the process of systematically coding the data, arranging and analyzing compiled data from the field with the aim of increasing and understanding

them clearly (Mugenda and Mugenda, 2003). Data analysis was to enable one to present the study findings more clearly. Before analysis, the data collected was checked thoroughly after which it was coded to enable the researcher to summarize, quantify and classify the data into forms that could suitably be used to prepare the report. From the information, the study developed narratives and interpretive report in by explaining the situation within the SACCOS.

A computer software Statistical Package for Social Science (SPSS) version 22 was used to analyze the quantitative data and to establish the relationship between credit risk and credit portfolio. Qualitative data was analyzed using percentages, pie charts, histogram and bar graphs. The data was tabulated for presentation by use of frequency tables, pie charts, and graphs. To arrive at conclusions that go beyond the immediate data alone and make inferences to accommodate general conditions, inferential statistics was used. Conclusions, suggestions and recommendations were drawn from the analysis.

3.8 Ethical Considerations

The study applied all ethical procedures in the study. The standards of conduct were applied throughout by distinguishing the likes and dislikes of the respondents. The considerations helped the researcher to understand and determine the difference between acceptable and unacceptable behaviors. First, ethical standard prevented against the fabrication or falsifying of data and therefore, promoted the pursuit of knowledge and truth which was the primary goal of the study. Ethical behavior was also critical for collaborative work because it encourages an environment of trust, accountability, and mutual respect among researchers.

3.8.1 Informed Consent

The researcher adopted code of ethics and policies laid down by MUA University which outline ethical behavior and guides researchers on the fields of study. These coded addressed issues such as integrity, responsiveness, honesty, objectivity, respect for all intellectual property, social responsibility, confidentiality, non-discrimination among others.

3.8.2 Voluntary Participation

Informed consent and voluntary participation was highly up held. The principles of willingness were followed to the later to guarantee the objectivity of all subjects of the study who choose to participate out of their own free will . The respondents in the study were fully informed of the procedure and any potential risk involved. Confidentiality and anonymity of the respondents was highly protected.

3.8.3 Confidentiality

The researcher treated all the information obtained from the field with strict confidentiality. The information got from the field was only accessible to the research supervisor and the researcher only and was not to be divulged to any other person without the consent of the University. However, the information disclosed to the supervisors was based on principals of trust as per the University rules and regulations.

3.8.4 Privacy

The privacy of a study can be defined in terms of a person having control over the extent to which timing and circumstances of sharing oneself (physically, behavior or intellectual) was protected. Having this in mind, the researcher ensured that the

information collected and information of the respondents acquired was secured to grantee the privacy of each respondent.

3.8.5 Anonymity

Anonymity in research refers to data collected from respondents should be completely unknown to anyone associated with the survey. The researcher made sure that only the respondents knew that they participated in the survey and the researcher mandate with the respondents ended there and the researcher cannot identify the respondents. The researcher made sure that the data collected in the survey and all possible identifying characteristics were separated from the publicly available data.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSIONS

4.0 Introduction

The chapter presents the data analysis and interpretations of the data on the assessment of credit risk management practice adopted by SACCOs in Tharaka Nithi County.

4.1 Data Collected and Analyzed

Questionnaires were distributed to the sampled 35 SACCOs in Tharaka Nithi out of 35 responded 4 declined to respond. This represented a response rate of 88%. Mugenda and Mugenda (2003) observed that when the response rate of a study is over 50% it is considered adequate for analysis and reporting, and when the response rate is over 60% is good and 70% and above is very good for data analysis. The response rate for the study was 88% which is adequate and very good as per Mugenda and Mugenda (2003) recommendations.

Table 4.1 Overview of Data Collected

Population	Number of targeted SACCOs (n)	Returned Questionnaires (r)	Non- Response rate (tr)
SACCOs	35	31	4

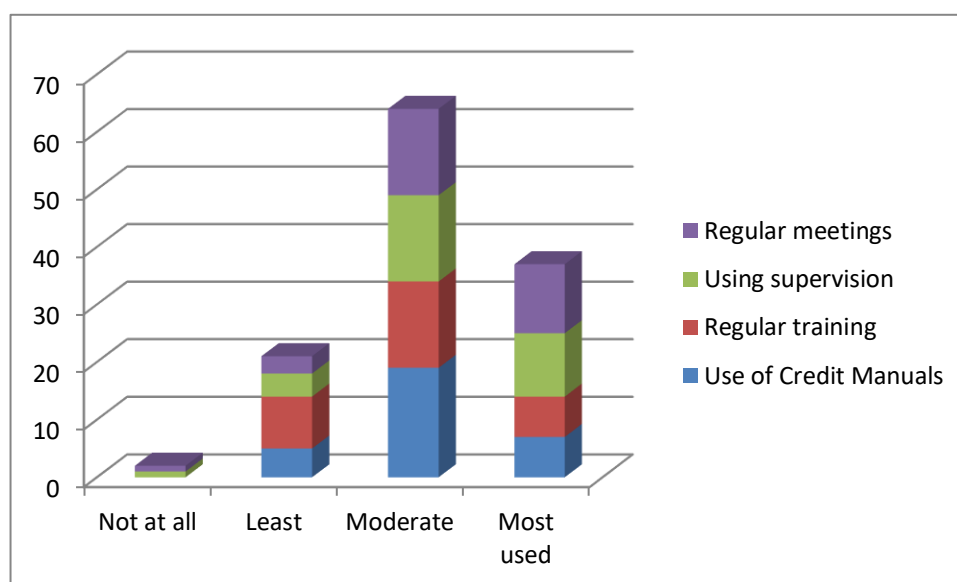
Key: n = population; r = Returned Questionnaires; n-r = Non-response Error (12%)

4.2 Descriptive Statistics

4.2.1 Methods used in bringing credit risk awareness to staff Table

4.2 Method of credit risk awareness

Method	Not at all	least	moderate	Most used
Use of credit manual		5	19	7
Regular training		9	15	7
Using supervisions	1	4	15	11
Regular meetings	1	3	15	12



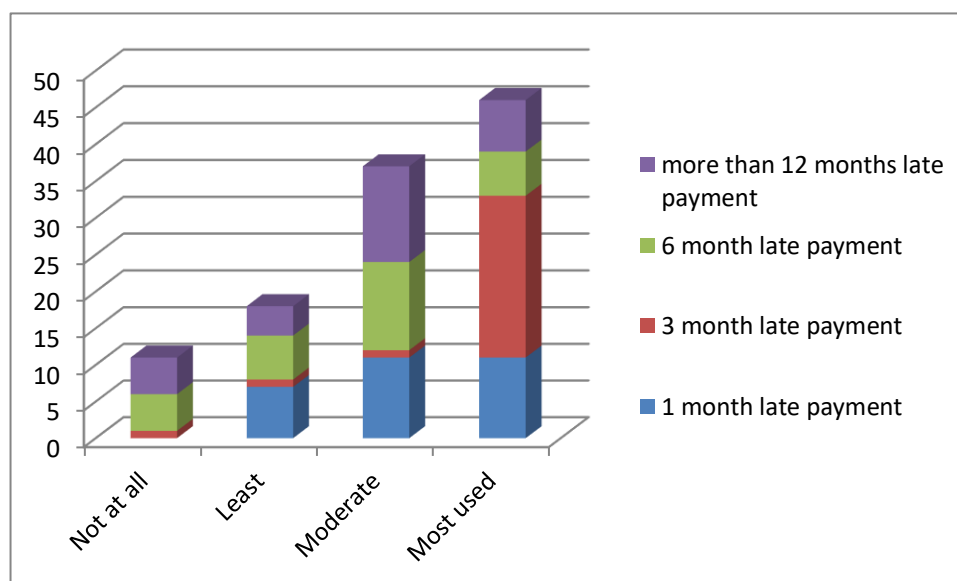
The study established that the most popular method of promoting credit risk awareness in the SACCOs was through regular meetings and supervisions. . The use

of credit manuals is also regularly used but its application goes hand in hand with regular meetings and supervision. Regular training also features amongst the awareness methods but less prominently than the other three methods.

4.2.2 Credit default policy Table

4.3 Credit default period

Period	Not at all	Least	Moderate	Most used
1 month late payment		7	11	11
3 month late payment	1	1	1	22
6 month late payment	5	6	12	6
more than 12 months late payment	5	4	13	7



Most SACCOs followed the 3-month (90 days) credit default policy as indicated by the table above. Of the 31 SACCOs interviewed, 22 stated that they mostly use the 3-month late payment period as the benchmark for credit default. However, it also became apparent that the SACCOs use a combination of credit default policies as opposed to just sticking to one but all in all the 90- day late payment was the most popular followed by the 1-month (30-day) benchmark.

In the same area, it was established that 28 (80%) of SACCOs reviewed their credit policy annually, while the remaining SACCOs reviewed their credit policy in half-yearly. Further, majority of SACCOs representing 28 (80%) strongly agreed that credit risk management practice had a positive impact on the SACCOs, because it ensured there was good organization on caring out responsibilities to meet the credit portfolio objectives.

4.2.3 Favored credit risk management practices in managing credit risk exposure

Chart 4.1 Favored credit risk management practices

Credit enhancement	5
Credit control policy	12
Credit approval	14
Credit limit	23
Credit diversification	4
Credit documentation	5

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Credit risk managers in SACCOs use a combination of methods but the most favored one was the credit limit followed by credit approval and credit control policy respectively as shown in the graph above. The credit limit does not only cap the upside risk but it also ensures a wider distribution of loans to SACCO members as no one person or group can get a disproportionately high loan amount at the expense of others members soliciting for loans.

4.2.4 Credit risk measurements used by SACCOs

Chart 4.2 Credit risk measure(s) used by SACCOs

	percentages
Credit scoring mechanism	24.14
Qualitative models	3.45
Newer models	13.79
Others	58.62

Most of the SACCOs interviewed indicated that they used qualitative methods while the credit scoring system was applied by very few. This may be indicative that SACCOs have not enhanced their capacity for credit assessment and may thus need to investment more in objective systems rather than relying on subjective approaches such as the qualitative approach. On the other hand, most SACCOs lend to members

who in many cases have a consistent monthly income stream and as such they use these streams of income as security. As a result, they may not need a complex measurement system to regulate credit given that client incomes are to a large extent predictable and consistent.

4.2.5 People responsible for credit policy formulation

Table 4.4 Credit policy formulation pane

People	Not at all	Least	Moderate	Most used
Executive Management	1	3	12	15
Board of directors			12	19
Credit committees		2	9	20
Credit managers		4	18	9

Credit committees, boards of directors and credit managers respectively for the most part are responsible for credit policy formulation in the SACCOs interviewed. The executive management also registered a sizeable impact on credit policy albeit somewhat diminished when compared to the first three avenues of credit policy formulation.

4.2.6 Credit risk management practices in the respective SACCOs

Table 4.5 Credit risk management practices

	Strongly agree	Agree	Not Sure	Disagree	Strongly Disagree
Credit decisions are made after standardization	11	10	10		
Credits must be monitored and reviewed	24	7			
Portfolio managers should watch over the loan	21	6	4		
Member lending facility is reported to the credit	11	15	4		1
Risk management practices are monitored and set	13	9	9		

Most respondents agreed on two things; credit must be monitored and reviewed and that portfolio managers should watch over the loan. This is reflective of the operations of most SACCOs in which there is regular monitoring of the loans and loan portfolio managers are made to account for loan performance.

4.2.7 Initial screening and risk assessment factors to SACCO lending

Table 4.6 Screening and risk assessment factors

Factor	Not at Least	Moderate	Most used
all			
Character of borrower	1	9	21
Capacity	1	17	13
Conditions		15	16
Collateral/ Security	1	16	14
Other			

The character of the borrower was the most prominent criteria used in screening of potential borrowers amongst the 31 SACCOs. The SACCOs also set some conditions mainly involving duration of membership and amount saved. Collateral was also used but it was not the core criteria given that most SACCOs are able to attach member's incomes (salaries) and hence use these income flows as security. On the other hand, SACCOs that do not deal with salaried members, such as those comprising business people and artisans, are keener on collateral.

4.2.8 Methods of loan recovery for clients experiencing difficulty in repayment

Table 4.7 Methods of loan recovery

	Not all	at Least	Moderate	Fair	Great
Letters of credit and telephone calls	5	9	9	2	6
Sale of property to recover money	12	13	3	3	
Debt write-off and account it as bad debt	6	14	6	4	
Write off interest and allow them to pay principal	7	12	4	7	1
Debt collection agencies	11	8	7	3	2
Legal action	12	8	3	7	
Other	1				

The responses brought out the fact that SACCOs try to avoid sale of property, debt collection agencies and legal action and as such these three loan default redress mechanisms are normally applied as a last resort. However, the SACCOs also try to avoid debt and interest write offs and instead prefer loan renegotiation and restructuring. All in all, letters of credit and telephone calls appear to be the most preferred first line of defense in dealing with clients who fall behind their loan repayment schedules.

4.3 Factor Analysis

Table 4.8: Total Variance Explained

Component	Initial Eigen Values			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	6.336	90.516	90.516	6.336	90.516	90.516
2	.401	5.733	96.249			
3	.260	3.709	99.958			
4	.003	0.42	100.000			
5	2.334E-16	3.349E-15	100.000			
6	9.467E-17	1.352E-15	100.000			
7	-2.447E-17	-3.495E-16	100.000			

Component (Factor)

Description

1. Sound credit risk management practices are built on good-quality portfolio management.
2. Better portfolio monitoring and delinquency tracking through the use of appropriate reporting tools help in delinquency management.
3. Credit officers must possess adequate appraisal and monitoring skills, experience and good knowledge of credit risk management practices.
4. Customers are offered good free consultant services.

5. The use of collateral particularly fixed assets to recover defaulted loans is successful to some extent in loan default recovery.

The factor analysis indicates that 90.5% of the respondents believe that sound credit risk management practices are built on good quality portfolio management. This is indicative that the SACCOs interviewed tend to focus on the quality of portfolio management but have not to a large extent assimilated credit risk management processes and tools as being part and parcel of sound credit portfolio management.

4.4 Summary and Implications of Findings

The study established that the most common method of supporting credit portfolio management awareness in the SACCOs staff was through supervision and through regular meetings. Out of 31 SACCOs, 22 of them posed that they have three months (90 days) credit default policy which every borrower should abide with to manage credit portfolio. On the other hand 28 SACCOs stated that they reviewed their credit policy framework annually, while the remaining SACCOs reviewed their credit policy every year (annually). Majority of SACCOs management (28) strongly agreed that good credit risk management practice impacted positively on credit portfolio management and ensured efficiency in carrying out the obligation of the SACCOs objectives. Credit risk managers in SACCOs use a combination of methods but the most favored one was the credit limit followed by credit approval and credit control policy respectively. Most of the SACCOs interviewed indicated that they used qualitative methods while the credit scoring system was applied by very few. Most respondents agreed on two things; credit must be monitored and reviewed and that portfolio managers should watch over the loan. This is reflective of the operations of

most SACCOs in which there is regular monitoring of the loans and loan portfolio managers are made to account for loan performance. Perhaps this also explains why the SACCOs rely on more subjective lending criteria through the use of qualitative models as opposed to the more objective credit scoring approaches.

CHAPTER FIVE

SUMMARY, RECOMMENDATIONS AND CONCLUSION

5.0 Introduction

The main aim of the study was to analyze the effects of credit risk management practices applied by SACCOs on loan portfolio in Tharaka Nithi county. To satisfy the objectives of the study, primary data was collected from 31 SACCOs. The secondary data for the study was collected from books, scholarly materials and from SASRA and SACCOs booklets, journals, credit policies and financial statements. The conclusion of the study was deduced and subsequently policy recommendations for SACCOs were indicated. The limitations encountered in the study were enumerated and suggestion for further study stated.

5.2 Conclusions

In conclusion the most common and popular method which SACCOs promotes credit risk knowledge among it staff was through regular meetings and supervisions on one on one basis. Majority of SACCOs hand a 3-months (90 days) credit default policy which ensured that the credit portfolio was managed well. In the same area, it was SACCOs reviewed their credit policy annually, while other SACCOs reviewed their credit policy in half-yearly. Also noted was that some SACCOs ignored the role of obtaining periodic financial information of borrowers and real estate appraisals to be used in evaluating the quality of loans in their books and the adequacy of collateral in hand. Further, majority of SACCOs respondents strongly agreed that credit risk management practice had a positive impact on the SACCOs, because it ensured there

was good organization on caring out responsibilities to meet the credit portfolio objectives. The finding concurs with (Kimathi,2007) who observed that credit review does not only assist the savings and credit cooperative society management to detect poorly underwritten credits but also assists in preventing weak credit from being granted. The fact that most SACCOs prefer to review credit policy annually may be compounded by issues of size and logistics as some of them have countrywide or regional reach and as such frequent changes in policy may lead to a dysfunction in their operations.

Further it is important for management of the SACCOs should and need to examine whether the loans borrowers and the lending financial institutions comply with loans contracts. The responsibilities and obligations of both parties need to be understood before extending loans. Njoku (2007) stated that an effective review and independent collateral appraisals are important as protective measure to ensure credits officers and other insiders are not colluding with borrowers.

Credit risk managers in SACCOs use a combination of methods but the most favored one was the credit limit followed by credit approval and credit control policy respectively. Most of the SACCOs interviewed indicated that they used qualitative methods while the credit scoring system was applied by very few. Most respondents agreed on two things; credit must be monitored and reviewed and that portfolio managers should watch over the loan. This is reflective of the operations of most SACCOs in which there is regular monitoring of the loans and loan portfolio managers are made to account for loan performance. However, this is also reflective of the fact that most SACCOs do not have, to a large extent, standardized approaches

to credit risk management and much is left to the discretion of the portfolio managers. Perhaps this also explains why the SACCOs rely on more subjective lending criteria through the use of qualitative models as opposed to the more objective quantitative methods such as credit scoring. The study corroborates with that of Branch (2005) which stated that credit management procedure has a profound influence financial stability of a SACCO. However, the main decision in credit management include decision by finance staff, loan management, asset management and production innovations.

5.3 Policy Recommendations

The study have shown that for the most part SACCOs rely on the on the watchfulness and keenness of credit managers skill on portfolio managers for useful credit risk management and this indicates the absence of a standardized and objective credit risk management system in most SACCOs. As they expand to incorporate more members in the various regions of the country the approach of relying on individual managers may prove to be inadequate and serve to increase the loans defaults. Accordingly, it is imperative that SACCOs adopt standardized credit risk management practices to avert the risk of default emanating from personalized systems.

5.4 Limitations of the Study

A study of this magnitude would not go without some limitations, and the first one was being a qualitative in nature and as such did not assess the financial performance of the SACCOs to back the questionnaire on the effect of credit risk management on loans portfolio among SACCOS. The scope of the study was very much restricted

geographically to SACCOs in the environs of Tharaka Nithi due to the limitation of time.

5.5 Suggestions for further study

Given the qualitative character of the study there is need for another study that would assess whether SACCOs use new technological tools in managing credit portfolios. In this age of micro finance advocacy a study may also be conducted to assess the economic impact of SACCO loans on the members who borrow from them and see whether there has been a marked improvement in their economic welfare on borrowing the loans.

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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION

MARY CIRINDI JOSEPH

c/o

MANAGEMENT UNIVERSITY OF AFRICA

Dear Respondent,

RE: THE EFFECTS OF CREDIT RISK MANAGEMENT ON LOAN PORTFOLIO
AMONG SACCOS IN THARAKA NITHI COUNTY, KENYA

My name is Mary Cirindi Joseph, a student at Management University of Africa currently carrying out a research on the above topic. The research is part of requirement for my programme in the University. Kindly fill the questionnaire as honestly as possible to enable this research to be successful. The information you give is needed purely for academic research and will be treated as confidential.

Your assistance and cooperation is highly appreciated. Thank you.

Yours truly,

MARY CIRINDI JOSEPH

APPENDIX 1I: QUESTIONNAIRE

Part A: General information

Name of Sacco (optional).....

Number of years the Sacco has been operatin.....

Current designation in Sacco.....

Years of service in the Sacco.....

Type of loan products offered by the Sacco:

Normal loan[] Instant Loan[]

Development Loan [] Emergency Loan []

School fee Loan [] Others (specify) []

Part B: Credit Risk Management Practices

1. What ways does your SACCO employ to bring credit risk awareness to staff?

Parties	1	2	3	4	5
Use of Credit Manuals					
Regular training					
Using supervision on one to one basis					
Regular meetings					

2. When does your organization decide that a client has defaulted on loan repayment?

Period	
1 month late payment	
3 month late payment	
6 month late payment	
more than 12 months late payment	

3. How regularly do you review your credit policy?

Quarterly..... []

Half yearly []

Yearly..... []

Other specify

4. The credit risk management practice in SACCOs ensures efficiency in its obligations of meeting the objectives.

Strong Disagree []

Disagree []

Neutral []

Agree []

Strongly Agree[]

5. Is it paramount for SACCOs to manage credit risks that it's exposed to?

Yes []

No []

If yes, explain your answer.....

6. Which practices among the following do you consider when managing credit risk exposure?

- a) Credit enhancement [] b) Credit control policy []
 c) Credit approval [] d) Credit limit []
 d) Credit documentation []
 e) Diversification across union members []
 f) Any other specify

7a). Do you use any credit risk management measures in your SACCO?

Yes []

No []

b). If yes please indicate which credit risk management measures used. (Tick where applicable)

Credit Scoring Mechanism..... []

Qualitative models []

Newer models []

Other specify

For questions 8 up to 12, Tick appropriately where 1 represents least considered and 5 represents most considered.

8. Tick below the people who formulate your credit policy.

People	Not at all	least	moderate	most
Executive management				
Board of directors				
Credit committee				

Credit managers				
Employees' suggestions				

9. To what extent do you agree with each of the following statement about credit risk management practice in your SACCOs?

Procedure	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Credit decisions are made after standardization process and documentation is required.					
Credits must be monitored and reviewed periodically for quality credit control.					
Portfolio managers should watch over the loan portfolio's degree of concentration and exposure.					
Member lending facility is reported to the credit risk management committee.					
Risk management practices are monitored and set by the credit committee					

10. Which factor(s) among the following does your SACCO use as an initial screening and risk assessment device before awarding credit to a customer?

Factor	1	2	3	4	5
Character of borrower					
Capacity					
Conditions					
Collateral/ Security					
Other					

Any other, Specify.....

11. To what extent does your SACCO apply the following methods in loan recovery when it is difficulty for the client to repay the loan on time?

Method	Not at all	Least extent	Moderate	Fair extent	Great extent
Letters of credit and telephone calls.					
Sale of the property to recover the money.					
Write the debt off and account it as bad debts.					
Write off interest and allow them to pay the principle.					
Debt collection agencies.					
Legal action.					

Any other, specify, Please specify.....

12. To what extent do you agree with each of the following statement about credit risk management in your SACCOs?

Statement	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Credit risk management is essential to optimizing the performance of the SACCO					
Sound credit risk management practices are built on good-quality portfolio management.					
Credit unions have adopted credit documentation as a ways of managing credit risk.					
The use of collateral particularly fixed assets to recover defaulted loans is successful to some extent in recovering defaulted loan.					
Better portfolio monitoring and delinquency tracking through the use of appropriate reporting tools help in delinquency management.					
Credit officer's must posses adequate appraisal and monitoring skills, experience and good knowledge of credit risk management practices.					
Customers are offered good free consultant service.					

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